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LABOUR STANDARDS IN A GLOBALISED ECONOMY SYMPOSIUM

How can customers promote labour standards?

NAZLI AGHAZADEH — 16 November, 2015



A realistic view on the capacity of social labelling

Among the most important forms of private initiatives for the protection and promotion of labour standards are social labelling schemes implemented by NGOs. These are for example Goodweave (formerly known as Rugmark), Fairtrade and the Forest Stewardship Council (FSC). Social labelling schemes have been spreading rapidly since the 1990s and the academic debate has grown along with it. The controversial question has been: Are social labelling schemes actually effective? Many authors (most recently Axel Marx and Jan Wouters) have suggested that social labelling schemes are supposed to enforce labour standards in supply chains. Accordingly, social labelling schemes are assumed to

be “effective” if they meet this condition. However, in view of the limited resources of NGOs in relation to the complexity of today’s supply chains, this assumption appears to overestimate the capacity of social labelling schemes. It rather becomes obvious that their capacity is restricted to market-based incentives. We therefore might be able to better understand social labelling if we look at it from an economic perspective. Ultimately, a regulatory approach will be necessary to overcome the current weaknesses of labelling schemes.

The idea of minimizing asymmetric information in the market

Imagine you are in a supermarket and you would like to buy a pack of orange juice. Your decision which one to take might be influenced by the particular ingredients in the juice. These can be taken from the packaging. Some contain additives, others do not. Would this information influence your decision? Probably yes. At the same time, information about the *production* of the orange juice is not conveyed to you. However, some orange juice is produced under good social conditions and other orange juice is produced under bad social conditions. Would you still buy the chosen one, without knowing to which category it belongs to? Probably yes. What if information about the production was given? Would this information influence your decision as well? Probably yes. This scenario is inspired by the theory of George Akerlof on asymmetric information in the market, for which he received the Nobel Prize in Economics in 2001. In his paper The Market for “Lemons” (1970), Akerlof uses “lemons” – which are basically used cars with poor quality – as an example to explain the effect of information

asymmetries in the market. Akerlof's theory provides a useful framework to understand social labelling.

Due to internationally dispersed production customers might not be familiar with social conditions in production. Social labels aim to provide this information for customers, as they are based on the idea that equal levels of information enable customers to decide in favour of those products which have been produced under good social conditions. Meanwhile, a lack of this information might rather render a decision in favour of products which are cheaper but actually produced under bad social conditions. In terms of Akerlof's theory, an adverse selection of "high quality products" (meaning produced under good social condition) might be caused. This is obviously not how an efficient market is supposed to work. In order to avoid this market inefficiency, social labelling schemes aim to minimize the information asymmetry between customers and producers and thereby turn the selection in favour of "high quality products". In this sense, social labelling schemes will be "effective" if they minimize the information asymmetry between customers and producers. Based on this understanding, are social labelling schemes effective then?

The limitations of social labelling schemes

Applying this framework to analyse Goodweave , Fairtrade and the FSC, it becomes apparent that their effectiveness is limited in various aspects.

In the case of Goodweave the monitoring system is a point of concern. Goodweave is unable to monitor the entire carpet belt to ensure that the labelled carpets have not been produced with illegal child work. The informative value of

the Fairtrade label is limited, given its system of distribution of benefits. There is no enforcement mechanism to ensure that workers subordinated to farmers equitably share in benefits. Last but not least, the FSC affirms that the labelled wood products have been produced in compliance with environmental and social standards. Yet, it is questionable whether the FSC can guarantee that the conditions in production have been audited with high performance. The FSC itself does not carry out the certification process. Instead, it accredits third certification bodies, which are commercial firms competing over prices, therefore audit costs, and therefore audit quality.

In each case an information asymmetry between producers and the implementing organizations remains and inevitably passes on to customers. At the same time, by giving “big promises” to customers, an information asymmetry between the implementing organizations themselves and customers is maintained, which can turn into mistrust once customers realize this gap. How can these limitations be overcome in order to make social labelling schemes more effective? What is needed to make social labelling schemes live up to their normative purpose as can be derived from Akerlof’s theory?

A possible solution: A regulatory approach

Basically, social labelling schemes need to be more transparent. They have to confine their evaluation to what they can really ensure. In pursuit of this, standards for labels might be useful. The labels would need to comply with these standards when being affixed on products. This is not a call for “standards for standards”, meaning that the standards for production circumstances, which the companies are required to comply with in order to receive a label, shall be

standardized among different labelling schemes. The standards, on which the organizations base their operations, must remain at their discretion, and depend on the organizations's objectives and resources. Instead, the standards proposed here are meant to regulate the information given by the labels as such, in other words the "outcomes" of the labelling schemes. These standards could require, for instance, that labels need to reveal the stage of the supply chain up to which they can guarantee to have overseen all crucial aspects like the production, the distribution of benefits and the certification. In the end, this requirement can strengthen the reliability of social labels.

Moreover, revealing information on the percentage of supply chain stages that have been overseen with certainty would incentivise producers to give auditors for social labels a deeper look into their supply chain, since producers would then compete for transparency. For example, producer A made 80% of its supply chain transparent, whereas producer B already revealed 95%. The difference in their capacities may also legitimize different prices, since more sophisticated implementation efforts are costlier. So, the more capable the labelling scheme is, the higher the product's price could be. Ideally, the "selection" according to Akerlof could then be turned in favour of products with strongly enforceable labels.

Hence, legal regulation of social labels might be a possible solution for achieving transparency and certainty, as both aspects are core competences of law. Further research from a legal point of view is necessary in order to consider in what way such regulation could be established.

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